

Letter from the President of the
Spring Valley Water Company
to the Special Committee of
the Board of Supervisors on
Water Supply.

in 76 Grace House

SAN FRANCISCO, April 13, 1908.

TO THE SPECIAL COMMITTEE OF THE
BOARD OF SUPERVISORS ON WATER SUPPLY:—

Gentlemen: At the conclusion of the interview on the evening of April 7th, between your Committee and officials of the Spring Valley Water Company, it was suggested that certain propositions which had been made at that meeting, in behalf of the company, should be reduced to writing, and in compliance with this request, we beg to submit the following summary of these propositions, and to outline to you the grounds upon which we ask you to establish rates for the coming fiscal year.

The physical conditions of the water supply may be summarized as follows:

The present safe capacity of the plant for distribution in San Francisco is thirty-five million gallons per day, and the consumption of the City approximates that quantity. The average consumption is at least thirty-two million gallons daily, but during the months of September and October of last year, exceptional days reached a consumption of thirty-six million.

By the expenditure of approximately two hundred thousand dollars in the erection of a new pump at Ocean View, and an additional force pipe line from Ocean View to Lake Honda, the delivery to San Francisco can be increased to forty million gallons per day, including the supply now taken from Lake Merced, and this work can be completed within the next four months, if undertaken immediately.

By distributing forty million gallons, we are trenching to the extent of five million gallons a day upon the reserve in the company's reservoirs. In the present condition of these reservoirs, this is not a serious matter, in view of the fact that an additional expenditure of from two hundred thousand to two hundred and fifty thousand dollars, which need not necessarily be undertaken this year, would make the company's daily yield of water actually deliverable in San Francisco fully equal to forty million gallons a day. As

was explained to your Committee, this additional five million gallons per day will be obtained by the installation of pumps at Ravenswood, which will increase the pressure upon the submarine pipes across the bay.

The City is in immediate and urgent need of the additional five million gallons daily, which can only be had—beginning at the expiration of four months from date—by the expenditure of five hundred thousand dollars spread over the coming two years.

Having reached this limit of forty million gallons, however, we are confronted with the fact that any further supply calls for the very large expenditure of money involved in one or the other of the plans for storage reservoirs in the Calaveras water shed, and the still greater expenditure involved in the construction of a necessary conduit for conveying this water to the City limits.

It is impossible, under present conditions, to predict, with any approximation to certainty, the growing necessities of San Francisco, and hence impossible to say when the City will be confronted by an absolute necessity for a greater supply than forty million gallons daily. It would take from three to four years, depending upon the seasonal rainfall, to provide these additional storage reservoirs in the Calaveras watershed and establish the conduits for bringing that water to San Francisco.

Under these circumstances, is it not self-evident, even under the lowest calculation of the City's growth in consumption, that immediate steps must be taken for the protection of the City against a water famine?

The water supply upon which the City must rely for at least ten years, can only be had from the Spring Valley system, as at present developed, and in the additional development of these Calaveras sources, which, if utilized to their utmost capacity, would afford a daily delivery of from one hundred million to one hundred and fifty million gallons and at much less cost than this additional water could be secured from any other source. There can be no question that this additional development will provide an ample supply for this City for the next forty years. (See Col. Heuer's report, page 8.)

The above summary of the physical conditions brings us to the question of how these additions to the property are to be provided for. This can be done only under two plans:

First: **The acquisition of the plant by the City and its development under the City's control;**

Second: **Its development by the company.**

PLAN FIRST.

As has heretofore been stated, the directors will recommend to the stockholders the sale of the property to the City for the face value of the issued bonds and the outstanding stock, approximating thirty-two million dollars; or if the City does not desire the Lake Merced property to be included in the sale, there may be a deduction of four million dollars from the price named, with the privilege to the City of using this Lake Merced property for purposes of a water supply only, for such time as this may be desirable, not exceeding ten years, on payment to the company of a net return of four per cent per annum on this four million dollars.

These are positively the lowest terms at which the directors will recommend to the stockholders the sale of the property, and if it is to be purchased by the City, it may as well be taken for granted, once and for all, that these are the best terms on which it can be obtained. I have repeatedly stated to you that the directors and stockholders firmly believe that this price is far below the actual value of the property, but considerations, which have been stated and made plain to you, have induced a willingness on their part to dispose of the property on these terms. The City does not permanently need Lake Merced as a source of water supply, and could not well use it for anything else than a public park. The land has a speculative value, which would be an inducement to the stockholders to retain it and thus, in a measure, compensate themselves for what they feel is a lower price than their property should command.

VALUATION BASED ON ESTIMATES.

The present City Engineer, in his estimate of value, expressly stated that he had not included that additional element of value which attached to the Calaveras properties by virtue of the fact that their permanent "serviceability" has been demonstrated by continuous use since the estimate made by Mr. Grunsky in 1901, from which Mr. Manson's figures were exactly taken.

From Mr. Grunsky's report, we quote the following:

"What element of value the lands on which the gravel beds of Sunol and the artesian wells near Pleasanton are located, may have acquired by reason of water development is difficult to answer with any degree of precision, particularly in view of the fact that in the one case the value depends upon the amount of water obtained and permanently obtainable and, in the other, largely upon the permanent serviceability of the natural filter."

In his report, Mr. Manson says:

"ONE OTHER FACTOR OF MOMENT WHICH THIS OFFICE HAS NOT BEEN ABLE TO CONSIDER IS THE VALUE OF THE ALAMEDA SYSTEM AS A PERMANENT SUPPLY WHICH HAS ONLY BEEN BROUGHT OUT BY CONTINUED USE."

This is a vital omission, and establishes, beyond the possibility of doubt, the fact that the valuation assumed by Mr. Manson is less than the real value of the property by whatever additional amount this permanent reliability of the Calaveras sources, as at present developed, may have established. As the permanent product of this part of the system now practically equals the product of the peninsula system, which was valued by Mr. Grunsky at about ten million dollars, it seems a fair assumption that approximately these figures should be taken as the present value of the transbay system, even though there be left out of the question its possibilities as a source of additional supply.

It is to be remembered, further, that the possibility of supplying the city with water for the next ten years rests absolutely upon the future development of these properties and that this prospective value, upon which the security of the

city's supply rests, is an important element, which has been entirely omitted in the valuation assumed by the City Engineer.

The lowest estimates of the value of the company's property have been made by the city engineers or by experts employed by the city. The highest estimates of value have been made by the company's engineer or by experts employed by the company. Admitting that all are striving to reach a fair end, it must be conceded that each party approaches the matter from a different point of view. For estimates of value by different engineers you are referred to Col. Heuer's report. You are occupying a position of neutrality as between the city and the company, and are charged with an obligation to deal fairly as between them. Is it not quite as unfair to the company for you to take the valuation of the city's experts, and close your eyes to the company's estimates, as it would be to the city for you to disregard its estimates and be controlled entirely by the company's valuations?

VALUATION BASED ON COST.

THE ACTUAL EXPENDITURE FOR THE CREATION OF THE SYSTEM WAS OVER TWENTY-EIGHT MILLION DOLLARS. An allowance for interest during construction added to the twenty-eight million dollars' actual investment will probably exceed the price at which the property can be purchased by the city. *This (twenty-eight million dollars) represents the actual cost of properties purchased over a period of more than forty years, the cost of development and the cost of the distributing system.* The value of these properties during the last forty years has greatly enhanced. An additional element of value rests in the demonstrated fact that they are now one complete homogeneous water producing system; and still another element of value over the cost is established business. The actual market value to-day of the Lake Merced lands alone over cost represents several million dollars.

VALUATION BASED ON PRICE OF SECURITIES.

The market quotations of stocks and bonds of the company have little to do with their actual value. Market quotations are controlled by supply and demand, financial conditions, income and municipal political conditions. The late Board of Supervisors passed a confiscatory rate for the sale of water, and passed an ordinance for the forfeiture of the franchise of the company. Such attacks affect market quotations, but they do not affect actual value. Is it not a matter of common knowledge that, in the present depressed condition of the money market, securities of many corporations can be bought in small lots at prices at which it would be altogether impossible to obtain a substantial holding?

VALUATION BASED ON COST OF REPRODUCTION.

While estimates of engineers and actual cost are aids in determining the value of such a property, AFTER ALL, ITS VALUE TO THE CITY IS THE AMOUNT OF MONEY NECESSARY TO BE EXPENDED TO REPRODUCE A SYSTEM CAPABLE OF RENDERING AN EQUIVALENT SERVICE. To reproduce a system capable of supplying to San Francisco forty million gallons of water daily, with potentialities of increase so as to admit of a delivery approximating one hundred and fifty million gallons daily, *would cost far in excess of any estimate of value placed upon the company's property*, and far in excess of the actual cost of the same to the company, and this without taking into consideration the element of established business.

It is interesting to note, in reference to the question of values, that the city of New York is now developing an increased storage and conduit supply to furnish the municipality with an additional one hundred and fifty million gallons per day at an estimated cost of one hundred and eighty million dollars.

PLAN SECOND.

The development of the Spring Valley water system by the company depends on the re-establishment of the credit of the company.

The re-establishment of the credit of the company depends fundamentally on the adoption of a schedule of rates that will, within the not distant future, allow a fair and reasonable return on the value of the property.

In fixing rates two elements must be considered:

First—What is the value of the property?

For consideration of the value of the property, we refer to what has been said heretofore under the heading "Plan First."

Second—What is a fair and reasonable return on the value?

The legal rate of interest in this State is seven per cent. Interest rates in this community on loans amply secured are from six to seven per cent. We cannot—for the purposes of this investigation—undo the existing law regarding the fixing of rates, no matter how illogical or unjust it may be. The law itself makes our income insecure (as evidenced by the treatment of the company by the late Board of Supervisors). This warrants the classing of the investment as somewhat hazardous, and hence entitled to a greater return than would be expected by an investor whose income was secured. Under the existing conditions of the investment, we are entitled, in all fairness, to a net return of seven per cent.

We ask you to fix rates that will yield a net income, in the not far distant future, of six or seven per cent on the actual value of the property necessarily used in providing and distributing the water to consumers. The rates we ask you to establish will not now yield, on a proper basis of accounting, a fair and reasonable income, but they will be accepted in the hope that they will tend to re-establish credit, promote co-operation between the city and the company and insure the community an abundant water supply.

THE RATES OF 1902.

To determine whether the 1902 schedule should be adopted, comparisons are absolutely necessary.

	1902.	1907.
Operating expenses	\$ 454,013.77	\$ 607,232.07
Taxes	236,828.97	314,933.07
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Total	\$ 690,842.74	\$ 922,165.14
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Gross revenue	\$1,980,651.72	\$1,907,272.20
Deduct operating expenses and taxes	690,842.74	922,165.14
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Revenue less operating expenses and taxes	\$1,289,808.98	\$ 985,107.06

The net result to the company on these three items was \$304,701.92 better in 1902 than in 1907, notwithstanding the following *capital expenditures for additional construction* from 1902 to 1907, viz:

1902	\$ 678,478.25
1903	680,767.01
1904	494,729.20
1905	566,114.08
1906	262,645.76
1907	355,493.21
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Total	\$3,038,227.51

A new and important increase in the operating expenses of the company has resulted from changed conditions arising from the earthquake and fire, in the increased and increasing consumption in the high-level districts of the city, which has necessitated the installation of two additional pumping plants operated at an annual expense of approximately fifty thousand dollars and whose capacity, in the near future, must be further enlarged to meet the pressing demands of the city.

The increase in cost of operation, aside from this, is easily accounted for by the greater cost of labor, which is forty

per cent higher than in 1902, and the additional cost of oil, other materials and, indeed, every element of expense entering into the operation of the property.

The company has always paid the highest rate of wages and secured the most efficient labor. It has enjoyed an unbroken record of tranquil relations with its employees. It has believed in good wages and good service.

In this connection it should not be forgotten that the taxes for 1908 will be three hundred and seventy-five thousand dollars, that is to say, one hundred and thirty-eight thousand dollars in excess of those for 1902, and sixty thousand dollars in excess of those for 1907.

It must also be borne in mind that the 1902 schedule made no allowance for depreciation or replacement.

In taking the 1902 rate as a basis, **no consideration has been given to**

INCREASED TAXES,

INCREASED OPERATING EXPENSE,

CAPITAL EXPENDITURES SINCE 1902,

DEPRECIATION AND REPLACEMENT.

Is there any honest or intelligent reason, or any rule of equity, for the denial to the company of proper allowances for these items?

RATE FOR 1908.

We have asked you for a fifteen per cent increase over the rates of 1902, except for shipping and contractors, a five-dollar city hydrant rate, and two hundred thousand dollars for a depreciation fund. Two hundred thousand dollars is ten per cent on an income of two million dollars. We will, therefore, assume, for the purpose of placing our requests clearly before you, that a twenty-five per cent increase on the 1902 rates, a five-dollar city hydrant rate and sixty thousand dollars for city parks, school buildings, etc., are to be allowed, and place before you the estimated return to the company on such a schedule.

Private consumers 1907\$1,710,032.00

It is not fair to assume that there will be an

increase during the fiscal year 1908, but

let us assume a five-per-cent increase..... 85,501.00

INCOME 1908.

Total estimated business from private consumers based on 1902 rates.....	\$1,795,533.00
Twenty-five per cent increase of rates.....	448,883.00
Five-dollar city hydrant rate	240,000.00
From city for buildings, schools, streets, parks, etc.	60,000.00
Shipping	122,002.00
Contractors (overestimated)	70,027.00
Other sources	60,482.00
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Total revenue from all sources	\$2,796,927.00

CONTRA.

Operating expenses	\$ 600,000.00
Operating expenses, depreciation, replacement	200,000.00
Taxes	375,000.00
Balance	1,621,927.00
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	\$2,796,927.00

This balance of \$1,621,927 yields:

- 5 per cent on a valuation of \$32,000,000;
- 5.4 per cent on a valuation of \$30,000,000;
- 5.79 per cent on a valuation of \$28,000,000;
- 6.2 per cent on a valuation of \$26,000,000; and
- 6.4 per cent on a valuation of \$25,000,000.

The above results are only obtained by charging an inadequate depreciation or replacement fund.

Whatever differences of opinion may exist as to valuation, the company is nevertheless entitled to the rates asked. IN OTHER WORDS, EVEN THOUGH THE PROPERTY BE WORTH NO MORE THAN THE CITY ENGINEER'S ESTIMATE, THE INCOME ON THE RATES REQUESTED BY US WILL BE NO GREATER THAN THE STOCK-HOLDERS ARE FAIRLY ENTITLED TO RECEIVE.

A critical and vital stage has now been reached in the relations between the city and the company, on whose property the city depends for its water supply. The credit of the company has been seriously impaired by attacks made

on the valuation of its property, by misrepresentations of its resources, by the agitation for a municipal water supply, by an insufficient income caused by low water rates, and by the effort of the late Board of Supervisors to forfeit its franchise. For years past the relations between the city and the company have been strained. If, in the past, the company were ever "in politics," for years its relations with the city have been free from any just criticism. The effort of the late Board of Supervisors to wreck the company is within your knowledge, and the straightforward manner in which that effort was met by the management is also within your knowledge. Is it at all likely that if the company had been "in politics" this confiscatory effort would have been made?

Early in 1906 changes in management were effected, and the company is now in the hands of representatives of the shareholders, who are themselves very large owners of stock. For years, the shareholders, numbering about two thousand, nearly all of whom are residents of San Francisco, have received but a small income from their property, and since January, 1906, they **have not only had no dividends**, but *have paid in assessments eight hundred and forty thousand dollars*, which was largely employed to repair damage caused by the earthquake. It seems to be assumed by some of your members that no credit is to be given for this item in arriving at the rates to which the company is entitled. An idea exists that the maximum rate of return to the shareholders is to be limited by the amount of dividends that will satisfy a buyer of gilt-edge securities, and yet that, if any unusual expense must be incurred to enable the company to furnish the service to the city, that expense must be borne by the company. It is only necessary to state this position to show its fallacy. IF THERE WERE NO LIMIT TO THE RETURN WHICH THE SHAREHOLDERS MIGHT RECEIVE, IT WOULD BE ENTIRELY PROPER TO EXPECT THEM TO MEET ALL EXPENSES OF EVERY NATURE, BUT IT IS UNFAIR, UNJUST AND ABSOLUTELY ILLOGICAL TO LIMIT THE COMPANY'S INCOME AND COMPEL IT TO MEET, OUT OF THE POCKETS OF THE SHAREHOLDERS, AN EXPENSE WHICH, HAD THE PLANT BEEN OWNED BY THE CITY, WOULD HAVE BEEN MET BY THE CONSUMERS THROUGH THE CITY TREASURY.

No business can thrive unless losses can be taken care of out of income. This is a fundamental business principle, which no one will controvert and without adherence to which no business man can long keep out of the bankruptcy court. No sane man would invest his money in an enterprise, the income from which was the lowest return which a first-class investment should command, if he knew in advance that the income could, in no event, be increased, but might be reduced, or indeed entirely wiped out, by losses incurred in the conduct of the business. **If it is confiscatory to deny to a public-service corporation a fair return for the service rendered, it is equally confiscatory to limit dividends to the lowest return for which money can be had in a safe enterprise, and yet say to the stockholders that they must use such dividends to meet expenditures without which the service cannot be rendered.**

How unfair to say to a public-service corporation, which, by act of God, has suffered a loss, that it is its duty to the community to repair the damage, **AND THAT IN THE FIXING OF RATES THE PUBLIC AGENCY WILL NOT TAKE INTO ACCOUNT THE COST OF SUCH REPAIR, BUT WILL ALLOW ONLY THE MINIMUM INCOME WHICH A SAFE INVESTMENT WOULD SURELY RETURN, LEAVING THE COMPANY TO MEET THE COST OF REPAIR OUT OF THE POCKETS OF ITS STOCKHOLDERS.**

If the Interstate Commerce Commission were to exclude any allowance for loss by wrecks and collisions and to fix rates upon a basis which would yield only the minimum dividend on stock, how many of the great railroads would long remain out of the hands of a receiver? And yet wrecks and collisions are not, as a rule, caused by the act of God. The Interstate Commerce Commission, which is the latest and most scientific development in governmental regulation, not only allows for actual losses of this nature, but makes provision for depreciation and replacement.

This amount of eight hundred and forty thousand dollars was used for replacement, no fund for which has ever been allowed or provided in rate schedules adopted by the Supervisors. Future rates must provide a replacement fund.

A review of the past also tends to show other just causes for grievance by the company. **Taxes in 1908 will amount**

to one hundred and thirty-eight thousand dollars more than in 1902. The city has, from year to year for the last seven or eight years, consistently reduced the allowance to the company for water furnished the municipality. RECEIPTS FOR WATER FURNISHED THE CITY HAVE DWINDLED FROM ABOUT TWO HUNDRED AND FORTY THOUSAND DOLLARS IN 1901 TO SEVENTY-NINE THOUSAND FIVE HUNDRED AND FIFTY-NINE DOLLARS IN 1907, *although the quantity consumed has constantly increased.* Since 1902 the company has annually brought suit to annul the rate schedule adopted by the Supervisors.

Last year the **Federated Committee**, the Chairman of whose Executive Committee was Col. Heuer, recommended an additional appropriation for hydrants of one hundred and eighty thousand dollars. We were explicitly promised this appropriation by the Chairman of the Finance Committee of the Supervisors, and on the strength of that promise *the company made large expenditures.* The appropriation was not made, AND THAT AMOUNT REMAINS TO-DAY A MORAL OBLIGATION ON THE PART OF THE CITY.

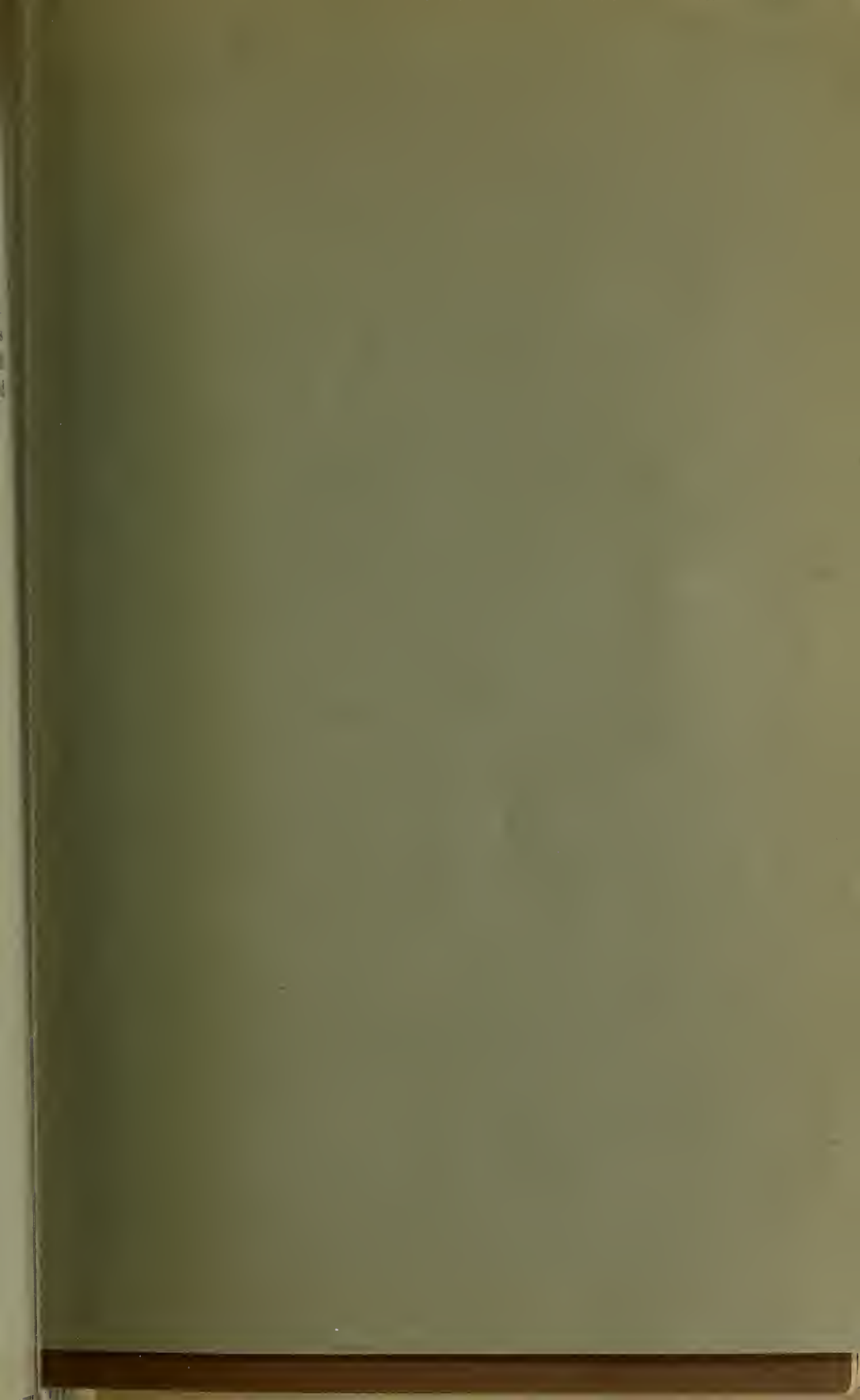
The policy of the present management is to upbuild the property. It seeks co-operation of the city authorities, and to that end will give the utmost publicity to its accounts. It will pursue a policy to promote the friendship of the public, and to remove prejudices, many of which have been caused by misrepresentation. If the rates asked for are granted, dividends for the fiscal year 1908 will be limited to four per cent, and if those rates are continued for the fiscal year 1909 the dividend shall not exceed five per cent; and when the dividends have reached six per cent, there will be no increase unless there shall be a reduction in rates. We assume, if, after this investigation, your Committee shall take such action as will result in the enactment for the year 1908 of the rates we ask, that they will be continued for 1909. If they are adopted, we shall, during the coming two years, expend at least five hundred thousand dollars in betterments so as to enable the company to meet all the needs of the consumers; this expenditure to begin immediately.

We are before you in good faith. We ask for your co-operation in maintaining, extending and improving the property upon which the city depends for its water supply.

Granting our request will go far toward restoring our credit, the establishment of friendly relations with the administration will make that credit secure, and it will be our hope that the company, which for many years has been the subject of bitter hostility, may be conducted in a manner so honorable and efficient as to deserve and receive commendation, thus enabling the officials and employees to devote themselves strictly to the business of furnishing an abundant supply of water, and to ultimately attain low rates for consumers and security for investing shareholders.

A. H. PAYSON,

President Spring Valley Water Company.





SIDNEY M. VAN VYCK, JR.
ATTORNEY AT LAW

219 CALIFORNIA STREET
SAN FRANCISCO, CAL.

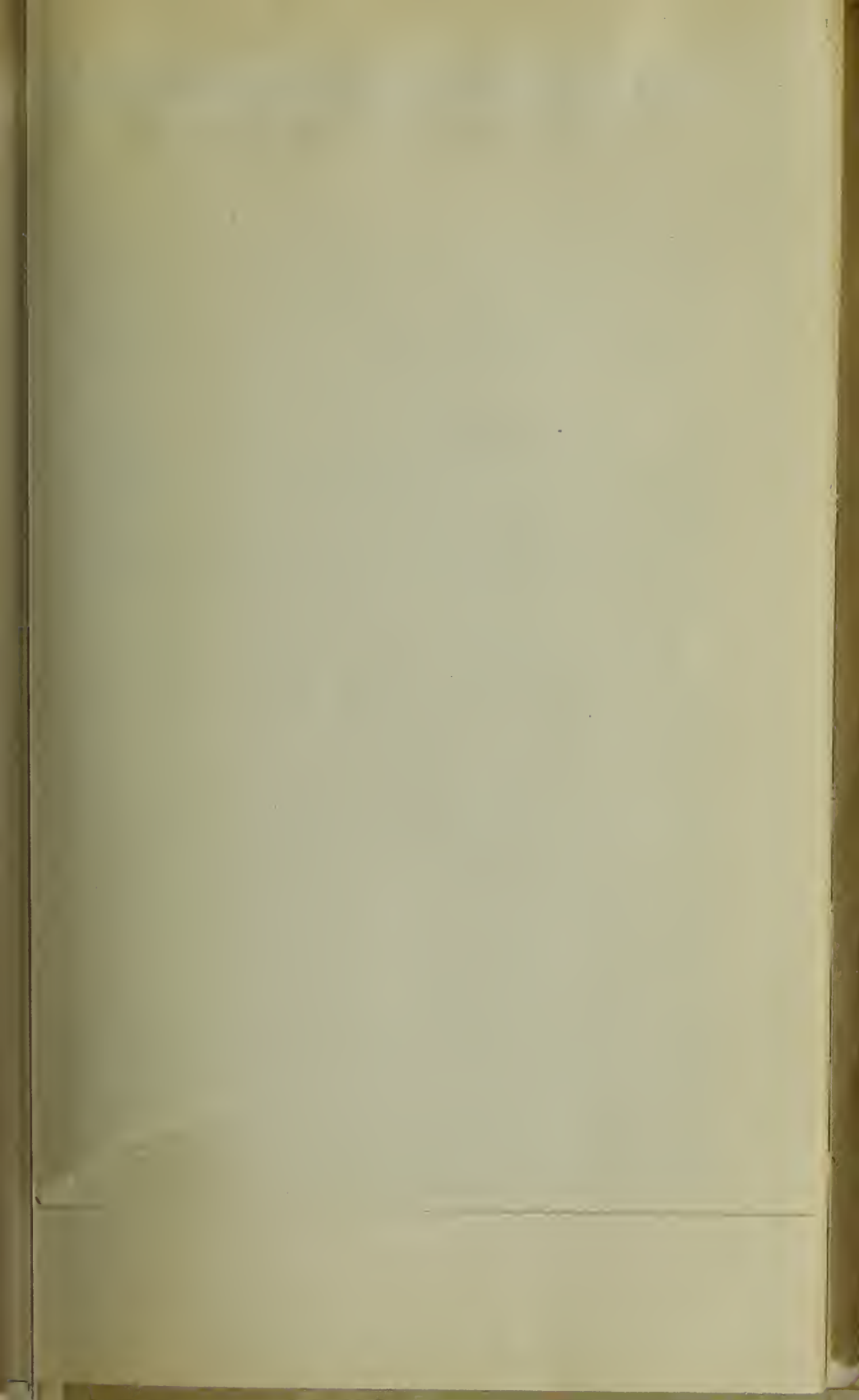
Report and Recommendation of
The Railroad Commission
of the State of California

In the
Matter of the Valuation
of the
Spring Valley Water Company's
Properties

Desired by the City and County
of San Francisco for a
Municipal Water Supply

San Francisco, California
November 24, 1920





MAYOR ISSUES STATEMENT ON SPRING VALLEY PURCHASE

My Fellow Citizens:

After nearly a year of intensive study of the properties of the Spring Valley Water Company the State Railroad Commission has fixed their value at \$37,000,000. A special election will be held within a few months and the question of purchasing this system by the city will be submitted to the voters. The situation is one that, I believe, demands a statement of what the policy of the administration is to be regarding the desirability of acquiring these properties, as well as the continuance of work on the Hetch Hetchy project.

San Francisco's water situation is critical. Additional water is absolutely essential to guard against the peril of a water famine. The water supply must be immediately increased. If the present winter rains are not sufficient, emergency construction will have to be undertaken in order to bring in additional water within twelve months or the city will have to be placed upon water rations. All expedients, such as the metering of the city and other devices to conserve the present supply have been exhausted. The need can only be met by more water. All this can only be obtained by the immediate development of Spring Valley sources.

The Railroad Commission says: "The City has already delayed too long in making this purchase, which has meant a very considerable loss to the city through inadequate water development. There is no escape from the conclusion that the present supply of water is dangerously near the point of insufficiency. Immediate steps to increase the supply should be taken."

The responsibility for the city's water supply is now divided between the City and a private corporation and the State Railroad Commission points to this as an impossible and ruinous situation. Either the City or the company must become responsible for furnishing an adequate supply of water to the City at all times. The people are already committed to owning and operating their own municipal water system. The City's interests and all of its plans for the future require that the Spring Valley properties be immediately purchased. The acquirement and development of the Spring Valley system is entirely in line with the City's larger plans, for a future water supply.

Failure to acquire these properties will greatly embarrass and tend to defeat these plans. The City can finance the development of these properties at lower rates of interest than the present company, whose cost of refinancing and necessary development of its properties will be immediately shown in higher rates to the users of water. The Railroad Commission in its report has definitely assured us of this fact. Therefore, I unhesitatingly recommend as a wise and necessary public policy that the City acquire the Spring Valley properties at the valuation placed upon them by the Railroad Commission.

As found by the Railroad Commission, the contemplated development of the Alameda system will increase our water supply to an extent sufficient to meet the needs of a population in excess of 700,000.

The City has gone ahead in good faith with the construction of the mountain division of the Hetch Hetchy project, which it is expected will be completed within three years, and will yield upwards of 66,000 electric horsepower, sufficient to pay the interest and take care of all fixed operating and maintenance charges of that part of the project. The purchase of the Spring Valley properties will not prejudice the Hetch Hetchy project. The immediate purchase of these properties is imperative. When acquired they will constitute an integral part of the Hetch Hetchy system, which it will take at least ten years to complete.

The present gross revenues of the Spring Valley Water Company exceed \$4,000,000 a year. The net revenues exceed \$2,500,000 per year. This fact alone shows the wisdom of the proposed purchase and guarantees a handsome profit to the City over and above all expenses.

It is the City's determination to continue the construction of the Hetch Hetchy project from the mountain division to the City only at a rate which will bring the first installment of Hetch Hetchy water to San Francisco when the present sources of supply have been developed to the fullest possible extent. This will enable the City to fully meet the water requirements of San Francisco, protect and hold all of its water rights for the future and permit the construction of the full Hetch Hetchy project in an economic and symmetrical manner and with the least burden to the taxpayers.

The City Attorney advises me that a bond issue for the purpose of purchasing the Spring Valley can occur simultaneously with an amendment to the Charter, increasing the bond limit to cover this requirement.

This particular amendment to the Charter was defeated at the last election, according to the best information obtainable by me, through the uncertainty on the part of the voter as to any specific amount to which this enlargement of the limit would apply.

It would seem reasonable that those who favor this necessary purchase would approve a specific amendment, making the issue of bonds for its accomplishment lawful.

Very respectfully,

(Signed) JAMES ROLPH, JR.,

Mayor.

San Francisco, December 4, 1920.

Report and Recommendation of
The Railroad Commission
of the State of California

In the
Matter of the Valuation
of the
Spring Valley Water Company's
Properties

Desired by the City and County
of San Francisco for a
Municipal Water Supply

San Francisco, California
November 24, 1920

Report and Recommendation of
THE RAILROAD COMMISSION
OF THE
STATE OF CALIFORNIA
IN THE
MATTER OF THE VALUATION
OF THE
**Spring Valley Water Company's
Properties**

Spring Valley Water Company,
Attention Mr. Sam P. Eastman, President,
375 Sutter Street,
San Francisco, California.

Board of Supervisors of the
City and County of San Francisco,
Attention Mr. Geo. Lull, City Attorney,
San Francisco, California.

Gentlemen :

In March, of this year, the Railroad Commission agreed to comply with the request of the City of San Francisco that we fix a fair and reasonable price which should be paid by the City for the acquisition of specified property belonging to the Spring Valley Water Company; the City to furnish a list specifically setting out the property desired.

The request of the City is contained in the Board of Supervisors' resolutions of January 7th, and of February 9, 1920. In the first of these resolutions the Board pledges itself to submit to the voters of the City and County of San Francisco

a proposition for the purchase, by the City, of the Spring Valley Water properties at a price to be ascertained, determined and recommended by the Railroad Commission, at a bond election to be called for such purpose as soon as practicable after the Railroad Commission shall have determined such price, provided the Spring Valley Water Company agrees, in advance of such determination, to sell at the price to be determined by the Commission.

Spring Valley Water Company, by resolution of its Board of Directors, dated February 11, 1920, agreed to submit to the stockholders of that corporation a proposition to sell to the City and County of San Francisco the properties selected at the price to be fixed by the Commission.

It was also the unanimous expression of the city officials, in conference with the Commission, that it would be very helpful if the Commission would express its opinion on the general question of the wisdom of the acquisition by the City of the specified properties of the Spring Valley Water Company, and the Commission was requested to express its views on any important factors which should weigh for or against such acquisition.

In making the necessary investigation and report, the Commission's departments were given liberty to consult freely with the engineers and experts of the City and of the Company.

The engineering department's report has been completed and, together with such other data as is available, has been given thoughtful consideration by the Commission. We are ready, at this time, to state our conclusions and it is the purpose of this communication to set forth, in a general way, the basis and reasons for these conclusions.

It should be made clear that, in acceding to the City's request and in announcing these conclusions and recommendations, the Commission is not acting in a strictly formal or judicial capacity. We have undertaken this task in a friendly spirit, intending to be helpful to the best interests of the City of San Francisco.

The Commission's present recommendations and conclusions result from an earnest attempt to find a fair basis for a fair price, both to the City and to the Company, for all of the property desired by the City, including physical property, structures, land, water rights, franchises, and the business now being done by the Company. It is our purpose to consider all elements, exaggerating none, and not ignoring or minimizing any.

1. Property desired by the City.

A list and description of the property desired by the City was furnished to the Commission by the city engineer, Mr. M. M. O'Shaughnessy. The list includes practically all of the lands, rights of way, water rights, structures, franchises, supplies, and materials on hand, complete records pertaining to the property and business of the Company, and there are excepted only certain parcels of land and certain buildings and structures.

2. The Fair Price.

The Commission's conclusion of a fair price is reached after giving consideration to what we believe are all of the important facts which should enter into this question. We have before us our engineering department's inventory of the property and the estimate of cost to reproduce the properties desired by the City. This estimate was not based on present 1920 prices for structures and plant, but on average prices for a six-year period from 1914 to 1920, a time which is considered a reasonable reconstruction period for this property. We have a very complete analysis of the present condition of the entire plant and of the amount of accrued depreciation. A careful appraisal of all the lands desired by the City has been made and the fair market value of these lands has been found.

In our effort to find a fair price, we have not been content to deal with the matter alone from the standpoint of reproduction cost less depreciation, but we have approached the problem from other angles as well.

Beginning with the figures agreed to by the City, and by the Company, in 1914 and 1915, we have proceeded on the assumption that the price agreed upon for the property then under consideration would today still be a fair price for the same property, after additional accrued depreciation is allowed for. To the then agreed figure we have added the actual cost of additional property since put in the public service by the Company, and have deducted property that since has been retired or gone out of existence. In this manner we have reached a figure after making all necessary adjustments, that can be compared with and, in a way, serve as a check upon the first figure based upon reproduction cost less depreciation. We have further gone into, and allowed for, the value of water and riparian rights, also of reservoir values, and the matters of the value of the franchises and business have been carefully considered.

It should also be stated that, in addition to the report of our engineers, there was available and there was considered by us, the inventory and valuation of the Company's property made in 1913 in the case of the Spring Valley Water Company vs. the City and County of San Francisco in the District Court of the United States. The report of the Master appointed by the Court in that case, and the federal decision of the federal judge, to the extent that that decision dealt with the matter of valuation, were also considered by the Commission.

It may be fairly stated that there has been as exhaustive an investigation of the properties of this Company as of any public utility in California and we feel that we have before us information in as great detail as might reasonably be obtained.

From all of this data, and from its own independent and best judgment, the Commission comes to the conclusion that the price for the property to be acquired, fair both to the City and to the Company, is \$37,000,000.00.

While it is true that in some degree the determination of a fair and equitable price for a property of this character is

a matter of opinion and judgment, still you may have the assurance that our conclusion is based upon a thorough knowledge of the facts and a judgment reached after a careful weighing of all of the matters which we consider important.

The Commission desires it understood that the figure recommended by us as a fair price cannot be considered in any sense as a "rate base," nor can it be taken as a finding in any proceeding affecting this property that might now be before the Commission or come before it in the future.

3. The question of the wisdom of the acquisition of the Spring Valley Water Company's properties by the City.

We are convinced that there can be no question of the wisdom on the part of the City of San Francisco of this purchase, if the properties can be secured at the price herein named.

The City has definitely, and we believe wisely, committed itself to a municipally owned water supply. This program, as a practical proposition, cannot satisfactorily be carried out unless the Spring Valley properties are first acquired. Theoretically it may seem possible to duplicate the water distribution system within the city limits, but an actual duplication is almost an impossibility. Not only is this true for the reason that, with the present system in place, the cost would be very large (much larger than the total of any reproduction cost estimate of the Spring Valley distributing system), but the legal complications, the delay and time required in the completion of a duplicate system, and the technical difficulties involved, to say nothing of the general destruction of the streets of the City and the interference with traffic, would make such a duplication a very serious undertaking. The waste resulting from such a duplication would be, in every sense of the word, unjustifiable.

The matter of the duplication of the distribution system is, however, not the most important or serious one. It is absolutely essential that the City, if it own its source of

water supply, be also in ownership and control of storage and general distribution reservoirs in the close neighborhood of the City. Such reservoirs will be required for the storage and distribution of water from Hetch Hetchy. The only suitable reservoirs actually in existence, together with potential reservoir sites, are the property of the Spring Valley Water Company.

If a condition could be imagined where the City could duplicate the Spring Valley distributing system, could find the necessary reservoir sites sufficiently close to the City, and did bring Hetch Hetchy water into San Francisco, there would then be two competing water systems serving San Francisco consumers. Even if city water were available in San Francisco, there is no legal power to compel discontinuance of service by Spring Valley Water Company to consumers. This could but result in wasteful competition and higher cost to the entire community.

The City would probably maintain the field in the end, but the Spring Valley Water Company could continue service for a long time, since it probably would be in a position to dispose of available excess water in the neighborhood of San Francisco on both sides of the Bay. The losses to both parties would progressively increase as the unreasonable and unintelligent struggle continued.

If the Spring Valley system is to be acquired by the City at all, it should be acquired now. In our opinion, the City has already delayed too long in making this purchase, and the failure of the bond election for this purpose, in 1914, has meant a very considerable loss to the City through inadequate water development, having in mind the future development of San Francisco and its continued growth. There is no escape from the conclusion that the present supply of water for the City of San Francisco is dangerously near the point of insufficiency. Immediate steps to increase the supply should be taken.

The water supply can be increased only in two ways: Either by the City doing its own development in the im-

mediate future, or by creating conditions where the Spring Valley Water Company can be put in position to proceed with such development. In view of existing conditions, it is not to be expected that the Company is ready or able to raise the necessary new capital for construction and extensions, and the City cannot afford to wait for an improvement of the urgent present water situation until the completion of the Hetch Hetchy system.

It has, for some time, been evident to this Commission that either the full responsibility of supplying water to the citizens of San Francisco must be assumed by this Company or by the City. If the City is not to purchase the Spring Valley properties, then it undoubtedly is the Company's duty to go forward and make the necessary investment to furnish an adequate water supply to this community for its present and future needs. If it be determined that the City does not purpose supplying its citizens with water at this time, then this Commission properly will insist that the Company take the full responsibility for this service and meet its obligation by the necessary capital expenditures coupled with adequate plans to operate for the future.

It will not do to say that this program of development may be entered upon by the Company and that the City, nevertheless, may purchase at any time it sees fit, because it must be remembered that whatever investment is made by the Company must be compensated for later by the City. In addition, the development undertaken by the Company will probably go forward in conflict with the plans which the City might adopt if it entered into this service.

We believe that from every standpoint a deliberate choice should now be made by the citizens of San Francisco, either for the continuance of water supply by the privately owned Company with the full responsibility placed upon that Company for such development as will safeguard the water needs of this community for the future (with which, of course, must go reasonable assurance that the investment made by the Company for this purpose will not be destroyed), or that the

City will promptly enter into possession and ownership of its own water supply and thereafter occupy the field completely. We consider a continuation of the present condition as a danger to the community as far as its water supply is concerned and we urge that a definite decision be reached at the earliest possible date on this important matter.

The argument is advanced that San Francisco will not, in any reasonable future, need the combined Spring Valley and Hetch Hetchy water supply. Aside from the fact that it will be years before Hetch Hetchy water can possibly be brought into San Francisco, there need be no apprehension of any permanent surplus of water anywhere within the state of California. The experience of the city of Los Angeles has shown that instead of there being a permanent surplus, even under the most favorable conditions, there is now a market for the water exceeding the supply.

The outlay on the part of the City for the purchase of the Spring Valley system need not result in an added tax burden on the people of San Francisco. With efficient operation and under reasonable water rates the purchase of the Spring Valley system will carry itself.

It may be assumed that the Calaveras Dam will be completed in the case of the purchase of the system by the City. The completion of the Calaveras reservoir will make available an additional supply of water sufficient to take care of the present urgent needs of the City. It is estimated that this addition to the Spring Valley plant will be sufficient to meet the demands of the City until the completion of the Hetch Hetchy system and supply the needs of a population in excess of 700,000.

The total acreage of the Spring Valley lands to be acquired is 61,735. This is an area over twice as great as the entire land area of the City and County of San Francisco. The City, we believe, is wise in acquiring all of this land. It is not to be inferred, however, that the total area can be used only for water purposes. A considerable portion is now

classed as non-operative for rate-making purposes. The City, in acquiring these lands, could resell a portion or they could be devoted to agricultural, park, building, and other purposes.

If the property is purchased as recommended by us, the element of severance damage will disappear. If, on the other hand, the Spring Valley were left with a portion of its property, which portion, however, could not be devoted to the purposes of a water utility, the matter of severance damage would unquestionably come up and assume large proportions in terms of money.

4. Terms and conditions of proposed acquisition of property and taking over of operating control by City.

We have not attempted to go into the matter of definite terms and conditions under which this property should be taken over by the City. If, in the working out of detailed arrangements for acquisition and operation, or in any other matter, this Commission can be of any service to the City, we at this time offer our continued friendly cooperation.

Yours very truly,

**RAILROAD COMMISSION OF THE
STATE OF CALIFORNIA,**

(Signed) EDWIN O. EDGERTON,
 “ H. D. LOVELAND,
 “ FRANK R. DEVLIN,
 “ H. W. BRANDIGE,
 “ IRVING MARTIN,

Commissioners.

